

VZCZCXRO7388
RR RUEHLN RUEHVK RUEHYG
DE RUEHDBU #0490/01 1000753
ZNR UUUUU ZZH
R 090753Z APR 08 ZDK
FM AMEMBASSY DUSHANBE
TO RUEHC/SECSTATE WASHDC 0371
INFO RUCNCIS/CIS COLLECTIVE
RUEHBUL/AMEMBASSY KABUL 0114
RUEHIL/AMEMBASSY ISLAMABAD 0087
RUEHBJ/AMEMBASSY BEIJING 0052

UNCLAS SECTION 01 OF 03 DUSHANBE 000490

SIPDIS

SIPDIS

DEPT FOR SCA/CEN

E.O. 12958: N/A

TAGS: [EAGR](#) [EINV](#) [ECON](#) [PGOVTI](#)

SUBJECT: TAJIKISTAN COTTON SECTOR HEADING FOR MORE TROUBLE, AS IS
BANKING SECTOR

DUSHANBE 00000490 001.2 OF 003

11. Summary: Visits to cotton growing regions and conversations with contacts in the Government of Tajikistan and in the development community show that the Government, despite declarations of "freedom to farm," is continuing its usual practice of coercing farmers to grow cotton. The "profitability" of the cotton sector relies on paying farmers below-market prices for their cotton, pushing them further into debt while enriching politically-connected middlemen -- the cotton investors or "futurists." The system is unsustainable; it discourages modernization of cotton cultivation and diversification into other crops, and helps push rural Tajiks to migrate for employment abroad, creating labor shortages in a sector which relies on manual labor. Food insecurity in Tajikistan will likely worsen in the coming season, and cotton production will fall, because of the lateness of planting caused by the harsh winter, March drought, and government mismanagement. End Summary.

12. EmbOffs received a snapshot of the troubled cotton sector during a recent visit to HIMA (Hayoev Ismatullo Murodali Alimardon), a cotton investment company 40 kilometers south of Dushanbe, partially owned by former Central Bank Chairman and current Deputy Prime Minister Alimardon. The other four major Tajik cotton investment companies also have close connections to the political elite, and are "profitable" by overcharging farmers for inputs such as seeds and fuel, while buying raw cotton from farmers at artificially low prices. Cotton farmers have told USAID contractors that investors pressure farmers into agreements without stating the price of cotton upfront and without explaining payment procedures. Investors almost always delay payments to farmers, particularly for those who have debts. Some farmers do not receive their payments until March and April of the next year.

Posing as a Cotton Investor, Acting Like a Feudal Lord

13. HIMA has operated in the Yovon district, 40 kilometers southeast of Dushanbe, for the past 12 years. HIMA owns a ginnery to process raw cotton. The ginnery was built by the Ministry of Agriculture in 1996 with used equipment 20 to 30 years old, then sold to HIMA in 11997. HIMA is now paying an Italian company to build a yarn factory in Yovon. The \$18 million project will be complete in late 2008, and will produce yarn for export. HIMA plans to employ 120 local women (preferred over men as they don't smoke as much and work harder), and a few men to manage them. The projected yearly production capacity of the factory will be 4000 tons of cotton yarn. Other Tajik cotton investment companies are building or have announced plans to build a half-dozen similar yarn factories elsewhere in Tajikistan.

14. Ismatullo Hayoev, HIMA's General Director, explained to us that HIMA has a competitive advantage over European yarn factories

because of the low cost of Tajik labor and because of very inexpensive electricity. While the people of Yovon do not receive electricity at home during the fall, winter, or spring seasons, HIMA's ginnery and new yarn factory have a guaranteed power supply from the Nurek Hydroelectric station and the Yovon heating station. Hayoev said that HIMA pays three cents (\$.03) per kilowatt hour, a small fraction of European electricity prices or the actual production costs in Tajikistan.

15. Mr. Hayoev, like Alimardon, has close ties to the President. He Q5. Mr. Hayoev, like Alimardon, has close ties to the President. He was one of the founders of the Tajik Sodiro Bank, is the son of former Prime Minister during the late 1980s, Izatullo Hayoev, and played an important role in President Rahmon's 1994 nomination.

Fluffy Profits for Investors, Empty Pockets for Farmers

16. The Yovon District was a cotton producer under the Soviet empire. A casual drive through the area shows the glaring poverty of cotton farmers. We passed village after village where residents were drawing water from canals. Electricity is intermittent for houses. We watched as young girls picked cotton plants by hand in the fields. Adult male labor is in short supply, because dire economic conditions for farmers have caused many men to go abroad for work. We spoke with several cotton farmers at a roadside stop arranged by Mr. Hayoev. The farmers said that they expected life to get more difficult for them in the next year, because of the shortage of labor, and the lateness of the cotton harvest and planting. The late harvest and planting ("we were under orders from the government to keep harvesting cotton until December" one farmer told us) were due in part to the recent unusually harsh winter, but also due to hesitation by cotton investors in providing inputs to farmers, as they waited while President Rahmon dithered over a new mortgage law for individual farmers. The legislation would provide farmers more independence by allowing them to borrow against their land, but the President did not sign it until March 20. Meanwhile, land usually prepared for cotton production in November and December was not

DUSHANBE 00000490 002 OF 003

planted until February and March this year.

17. When asked whether they could diversify into high value food crops, the farmers we met said this was impossible, because they had no way to market such products, could only deal with cotton investors, and met with official discouragement. Mr. Hayoev stood by during the conversation, seemingly unaware that anything was amiss with this state of affairs.

18. The central government has always required local authorities to devote large swaths of land to cotton production. Farmers have told us that local officials have destroyed non-cotton crops that were planted against their instructions. The Government is now endangering the banking sector, in order to keep money flowing to the cotton investors. The Government's "new cotton mechanism" supplied commercial banks with nearly \$30 million and ordered them to make low interest loans to cotton farmers. Commercial banks do not have the capacity to manage these loans. The Asian Development Bank estimates that 80-95% of cotton loans will become bad debt. These forced and risky loans could result in a banking sector meltdown by this summer or fall.

Historic Decline

19. Yovon District has grown as much as 35,000 tons of raw cotton per year, but in 2007 produced just 23,000 tons. In 2008 production is projected to be only 20,000 tons. On a national level, Tajikistan produced 420,000 tons of raw cotton in 2007, down from 444,000 tons in 2006. Cotton production in 2008 is expected to be 30-40% lower than 2007. According to the Ministry of Agriculture, the total annual production of raw cotton since 1991 has not exceeded levels of 1963. Yields per hectare are no higher today than they were in the late 1930s.

¶10. There are a number of reasons for declining output. Higher prices in fuel and other inputs (as a result of higher world prices) have led to lower production levels. Mass migration of farmers to urban centers, Russia, and Kazakhstan has reduced technical skills, which in turn has led to improper use of equipment and fertilizers. Farmers are not pursuing hybridization, which is necessary to maintain productivity. Crop rotation enforced during the Soviet period no longer takes place, leading to rapid soil depletion. And with the current semi-feudal arrangement of the sector, farmers have little incentive to meet higher production targets. Last year's unusually harsh winter forced many farmers faced with mounting debts and food shortages to sell livestock and already antiquated equipment in order to survive.

Can't Afford to Eat

¶11. Reduced cotton crops result in significant loss of farm income for basic necessities including food. More than half of Tajikistan's food needs are imported, and higher world food prices combined with lower rural incomes caused widespread rural hunger this past winter and spring. Authorities have talked of price controls to address this problem, which in turn has produced real food shortages in some locales, as sellers abandoned the market.

Comment - To the Bitter End (Bitter for Some, that is)

¶12. HIMA and the Yovon District provide a window into the cotton crisis currently plaguing Tajikistan. A politically-connected cotton investor collects large profits at the expense of the individual farmers and the national economy, preventing diversification and economic development, for the investor's short term gain. While last year's severe winter and energy supply troubles contributed to the cotton crisis, the underlying problem of the agricultural sector is the continuation of Soviet-era policies that force the country's farmers to produce cotton and discourage diversification into food production. An arrangement that once served the interests of a centrally-planned economy now provides money to a politically connected "mafia." This dysfunctional system resembles in many ways the mechanism for perpetuating the poppy industry in nearby Afghanistan; except here in Tajikistan, the policy is enforced explicitly by the government.

¶13. A confluence of declining cotton production, decreasing farm income, rising debt, increased food prices, and overstretched financial institutions could lead to an economic and humanitarian crisis worse than before. Unfortunately, government officials and their friends in cotton investing are bent on continuing to extract what money they can from the system until it collapses; then running to international donors for a bailout. USAID agricultural and land

DUSHANBE 00000490 003 OF 003

programs are designed to encourage alternate crops, assist in marketing, and help farmers secure land rights. However, we will need to press the government for significant reforms in order for these programs to have a real impact. End Comment.

JACOBSON